

CAPITAL PROJECTS AND BOND OVERSIGHT COMMITTEE

Minutes

January 15, 2008

The Capital Projects and Bond Oversight Committee met on Tuesday, January 15, 2008, at 12:30 PM, in Room 169 of the Capitol Annex. Senator Elizabeth Tori, Chair, called the meeting to order, and the secretary called the roll.

Present were:

Members: Senator Elizabeth Tori, Co-Chair; Senators Tom Buford, Jerry Rhoads, and Dan Seum; and Representatives Robert Damron, Steven Rudy, and Jim Wayne.

Guests testifying before the Committee: Representative Reginald Meeks; Senator Jack Westwood; Jim Abbott and Nancy Brownlee, Finance and Administration Cabinet; John Hicks, Governor's Office for Policy and Management; John Nicholson, Kentucky Horse Park; Major Wayne Mayfield, Kentucky State Police; Sandy Williams, Kentucky Infrastructure Authority; Jim Ackinson, Kentucky Higher Education Student Loan Corporation; Tom Howard and Terri Fugate, Office of Financial Management; and Rick McQuady, Kentucky Housing Corporation.

LRC Staff: Nancy Osborne, Shawn Bowen, Pat Ingram, Kristi Culpepper, and Lesa Prewitt.

Senator Tori asked Nancy Osborne, Committee Staff Administrator, to review the correspondence and information items. The first item of correspondence was the quarterly status reports from the Finance and Administration Cabinet and the universities that manage their own capital construction programs, Murray State University, Northern Kentucky University, University of Kentucky, University of Louisville, and Western Kentucky University. Some significant changes since the October 2007 submissions include project completions for the General Burnside golf course, the Lincoln Homestead - Mordecai Lincoln project, the East Wing / Hall Renovation project at the Kentucky Fair and Exposition Center, the Owensboro Technology Center on the main campus at Owensboro Community and Technical College (Kentucky Community and Technical College System), and the Renovate Molecular Biology Student Lab project at Morehead State University. It was noted that work on the Murray State University New Science Complex Phase II project has been suspended due to funding limits, and the UK Equine Isolation Facility is in construction with a completion date of May 2008.

The second item of correspondence was the quarterly status report on court facility projects submitted by the Administrative Office of the Courts (AOC). Since the October 2007 submission, four additional court projects are in construction in the counties of Grant, Adair, Jackson, and Pendleton. The third item was a spreadsheet reporting allocations from the Postsecondary Education Major Item of Equipment Pool for the period ending December 30, 2007.

Correspondence was submitted from the Department of Education in response to questions raised at the Committee's December 2007 meeting relating to the oversight of local school facility construction projects. The correspondence notes that the Department of Education's Division of Facilities Management is responsible for oversight of local school construction projects. School districts base their initial cost estimates on a formula that is applied statewide. To more accurately reflect the cost of new construction projects, revisions of the administrative regulations relating to the formula are underway to increase cost estimates by about 30%.

The final item of correspondence was from the Cabinet for Economic Development, Department of Commercialization and Innovation, reporting an allocation of up to \$500,000 from the New Economy High-Tech Construction/Investment Pool for Expungement Assistance Services, Inc. This grant is from the 2004-06 budget authorization which will have a balance of \$1.7 million if this grant is approved. The 2006-08 budget provided an additional \$20 million for the New Economy pool.

Ms. Osborne then briefly reviewed various items in the monthly Staff Update including Governor Beshear's budget reduction order and the destruction of the Carlisle County courthouse in Bardwell by fire.

Senator Seum asked if the Carlisle County courthouse was covered by insurance. Senator Buford said he thought there was some insurance coverage but not enough.

Representative Wayne asked what the standards were for insuring public buildings. Senator Buford said no standards exist for court facilities, which are owned by the county, and that it was up to the county government to provide insurance. He said the Carlisle County courthouse did not have a "replacement value" insurance policy.

Representative Wayne said this raises some very serious questions. He said the Commonwealth, at the taxpayer's expense, is financing court facilities that are not properly insured. Senator Buford said this would be a question the Administrative Office of the Courts (AOC) would need to address.

Representative Damron said underinsured public buildings is a bigger issue than just county government buildings. It applies to all parts of government, including schools, universities, and the state.

Senator Tori said this issue should be reviewed and asked the Committee staff to contact AOC and the appropriate state agencies regarding insurance of their facilities.

Senator Buford said he agreed with Representative Damron that this is an issue the Committee needs to address. Senator Tori said this was an issue not only at the state level but at the local level as well.

Ms. Osborne said members' folders also included a list of proposed legislation relating to the jurisdiction of the Capital Projects and Bond Oversight Committee, and the updated debt issuance calendar.

Noting that a quorum was now present, Senator Tori asked the secretary to call the roll. Representative Damron made a motion to approve the minutes of the December 18, 2007, meeting. The motion was seconded by Senator Seum and approved by voice vote.

Senator Tori invited Senator Jack Westwood and Representative Reginald Meeks, Co-Chairs of the Capital Planning Advisory Board (CPAB), to present the Board's 2008-2014 Statewide Capital Improvements Plan (Plan) to the Committee.

Representative Meeks said a copy of the Plan was delivered to each member's office in mid-November. He briefly gave the Committee an overview of the capital planning process, saying the actual development of the statewide capital plan occurs during a six-month time period beginning with the agency plan submissions in mid-April and concludes with the Board giving final approval to the statewide plan in late October.

Representative Meeks said the agency plans submitted to CPAB include the same projects that are later submitted through the budget request process for authorization by the General Assembly in the biennial budget. He said nearly 1,700 projects were submitted by the agencies of all three branches of government for the 2008-2014 six-year planning period, and the total estimated cost of the projects – from all fund sources – was over \$17 billion. Two-thirds of this amount (\$11 billion) represents projects submitted by the postsecondary education institutions.

Senator Westwood said adequately maintaining existing facilities continues to be the major focus of the Board. The 2008-2014 Plan outlines four policy recommendations to address facilities maintenance. Other policy recommendations approved by the Board reiterate recommendations made in prior plans. Project recommendations in the Plan focus on projects that would be financed from the state General Fund - either cash or debt. The Board recommends that funds be appropriated such that the three statewide funds, Emergency, Contingency, and Statewide Deferred Maintenance, each have a \$10 million balance to start each fiscal year. Also recommended is that maintenance pool appropriations for all agencies be significantly increased in the 2008-10 biennium and that funds be provided for equipment and information technology (IT) systems maintenance pools.

Senator Westwood said the Board recommends three projects to facilitate implementation of the long-range plan for housing state agencies in Frankfort and the Capitol renovation project. Multiple projects in each of three major categories have been recommended as well: 18 specific maintenance or renovation projects; 13 IT projects; and 19 new construction projects. He said the projects are listed in alphabetical order - prioritized rankings were not assigned.

Senator Tori thanked Representative Meeks, Senator Westwood, and Pat Ingram, CPAB Staff Administrator, for their hard work. She asked if a \$10 million balance was normal for the Emergency, Contingency and Deferred Maintenance funds. Ms. Ingram said at this time the

balances were at a historical low and the recommendation was to adequately replenish these funds.

In response to a question from Senator Tori, John Hicks, Deputy Budget Director, Governor's Office for Policy and Management (GOPM), said the Emergency Fund had a balance of \$2.3 million, the Contingency Fund was at about \$2.5 million, and the Statewide Deferred Maintenance Account had a zero balance. He said not too long ago, the year end balances were in the double-digit millions, especially the Contingency Fund. The average has been just under \$8 million over a 12-year period.

Senator Tori said the reason she asked these questions was because a budget would be prepared and it was important for the members to know the balances and what is recommended as a needed balance.

Jim Abbott, Commissioner, Department for Facilities and Support Services, and Mr. Hicks came to the table to present the monthly project report submitted by the Finance and Administration Cabinet. Mr. Hicks first reported an allocation in the amount of \$786,000 from the Emergency Repair, Maintenance and Replacement Account to relocate executive branch agencies from the Capitol Annex to space in the state-owned Bush Building, Hoge House, and Capital Plaza Fountain Place. The funds will also be used to reconfigure space in the Capitol Annex for its future use by the Cabinet offices that remain.

Mr. Hicks said House Bill 267, the 2004-06 budget, directed that additional space in the Capitol Annex be made available to the legislative branch. He said the Secretary of the Finance Cabinet determined that no other source of funding was available for this initiative and the project is eligible for Emergency Account funding if no other funding source is available.

Senator Tori asked Mr. Hicks to provide the Committee a final accounting of the project when it was complete. Mr. Hicks said he would do so and added that the project will not be completed until April 2008. To date, \$511,000 has been spent. No action was required by the Committee.

Mr. Hicks invited John Nicholson, Executive Director, Kentucky Horse Park (KHP), to the table to discuss an unbudgeted project at KHP. The project entails construction of a new museum gallery dedicated to the history of the horse in the far east. The scope is \$7,000,000 and is 100% privately funded from the Arabian Horse Trust.

Mr. Hicks said the project will be a two-story building with 8,700 square feet and located next to the current International Museum of the Horse. The Arabian Horse Trust is controlled by the Purebred Arabian Trust organization and is a charitable nonprofit corporation that exists for the purpose of promoting and fostering the preservation and use of the purebred Arabian horse. This private entity will construct and furnish the building and provide an endowment to finance the exhibits, artifacts, and programs. Mr. Hicks said the endowment will also be used for costs associated with maintaining the museum. The state will own the facility and furnishings, and KHP will be responsible for operating and maintaining the museum.

Senator Tori asked why the state is not managing the construction of the building since it was located on state property. Mr. Hicks said it is a state project on state land and it will be to the benefit to the state and the donors, the Purebred Arabian Trust. He said the Trust has agreed to abide by all state procurement and prevailing wage laws. For the construction of the building, the Trust had indicated that maintaining control of the procurement of the construction would aid their fund-raising for the project.

Mr. Nicholson said the Kentucky Horse Park has enjoyed creating partnerships and relationships with horse enthusiasts and horse organizations throughout the United States and the world. KHP is pleased that the donors to this project have confidence in the Arabian Horse Trust, and they want to see the promotion of the oldest breed of horses in the world at KHP. Mr. Nicholson said by enhancing the attractions at the park and making them more compelling and historically relevant, more revenue will be generated. He said KHP is especially interested in doing this as the 2010 World Equestrian Games draw near.

Senator Tori said it was very important for the Committee to know that the construction of the project will abide by all state regulations.

Senator Buford made a motion to approve the project. The motion was seconded by Senator Rhoads and approved by unanimous roll call vote.

Senator Tori next asked Nancy Brownlee, Director, Division of Real Properties, to discuss an emergency lease report and five lease modifications. Ms. Brownlee first reported a temporary emergency lease (PR-3887) for the Kentucky State Police (KSP) in London. She said Real Properties was requested to advertise a project to secure approximately 10,000 SF of office and expanded lab space.

Ms. Brownlee said the request was intended to replace the existing lease which expired June 30, 2007. Site evaluations were completed in October and November 2005, and the planning and specification process for the expanded lab space took the better part of 2006 due to lab space design being more complicated than office space design.

In 2007, after the final proposals were received, Real Properties was advised by KSP that sufficient funding was not available to support the requested lab expansion and it would seek funding for the expanded lab in the 2008 session. However, lab case loads dictated that the existing lab continue operating until such time that a decision was made on funding and a new project completed. The existing lease was due to expire June 30, 2007, and the lessor was unwilling to renew the lease under the same terms and conditions. Real Properties tried to negotiate for lower rates, but those negotiations were unsuccessful.

Ms. Brownlee said the temporary lease renewal was deemed to be an emergency because it was not cost effective to follow the usual process and advertise for replacement space that does not meet the current needs of the agency. Also, it would not be appropriate for a new lessor to incur significant lab fit-up cost for replacement space that could shortly thereafter be subjected to the risk of relocation by KSP if the expanded lab project is funded. KSP advised that the consideration of a temporary relocation or transfer of pending cases to another lab facility would

cause the agency to incur significant costs and possible loss or reduction of agency services. No action was required by the Committee.

Representative Wayne asked why the lab construction project was given a low priority in the Justice Cabinet's Six-Year Capital Plan. (Cabinet Priority 36 of 42 projects submitted by the Justice and Public Safety Cabinet.) Major Wayne Mayfield, Commander for Forensic Sciences, KSP, said the state police has a number of other needs that take precedence.

Representative Wayne said he occasionally hears that KSP does not have enough trained officers and proper facilities. He then asked if there has ever been a blue ribbon task force that developed a comprehensive look at the operational needs of KSP and communicated those needs to the General Assembly. Major Mayfield said the current KSP commissioner and the past KSP commissioners have solicited input from the command staff to develop the agency needs. These needs are communicated to the Justice Cabinet, which then sets the priorities. He said as manager of the KSP lab system, which consists of six laboratories and 135 employees statewide, he identified a need for over \$8 million for 2008-2010 in the agency's six-year capital plan.

In response to another question from Representative Wayne, Major Mayfield said there were a number of projects KSP has tried unsuccessfully to get funding for in the past.

Senator Seum said that prosecutors have told him that they are having problems getting their cases in due to the backlog of uncompleted lab work. Major Mayfield said KSP has several analytical disciplines and some of the disciplines, such as DNA, have a tremendous backlog that continues to grow. Currently, there is a four to six month backlog in DNA cases. Each month KSP continues to receive more DNA analysis requests than it can perform.

Major Mayfield said the primary reason KSP initiated this lease request in 2004 was to get the entire lab system accredited. This was a significant project for KSP, and in 2005, KSP was able to get three of the six labs accredited. Attaining accreditation for the London lab is one of the two primary pushes behind this project. The other reason is this small lab space does not meet their needs in terms of personnel and the ability to get the work completed quickly. In terms of the DNA backlog, this lease renewal has no effect. No action was required from the Committee.

Ms. Brownlee then reported five lease modifications. Four of the modifications converted smoking rooms to office space in Cabinet for Health and Family Services (CHFS) offices in Anderson, Fayette, Franklin, and Warren Counties. The remaining modification was for structural renovations to create two additional private offices for the Department of Public Advocacy in Franklin County. Lease modifications of less than \$50,000 are to be reported to the Committee, and no further action was required.

Senator Tori next welcomed Sandy Williams, Financial Analyst, Kentucky Infrastructure Authority (KIA). Ms. Williams presented various coal/tobacco development grants that were funded through line item appropriations from the General Assembly in the 2004-06 and 2006-08 budgets.

The next report was provided by Tom Howard, Executive Director, Office of Financial Management (OFM), and Terri Fugate, Deputy Executive Director, OFM. Mr. Howard said there were three new debt issues to be presented. The first item was a new bond issue for the Kentucky Higher Education Student Loan Corporation (KHESLC) Student Loan Revenue and Refunding Bonds (2004 Trust Restructuring), \$1,345,396,425. Proceeds from this issue will provide money to originate Federal Family Education Loan Program student loans and redeem and refund existing senior taxable and tax-exempt auction rate bonds. Jim Ackinson, Chief Operating Officer, KHESLC, was invited to the table to discuss the bond issue.

Mr. Ackinson said this was the largest bond transaction in the history of the organization. He referred to an executive summary in members' folders, and said KHESLC issues variable rate bonds in order to fund student loans. The executive summary also describes the events of the past year as related to the liquidity crunch in the capital markets. He explained that problems with sub-prime mortgages have affected other types of asset-backed securities, including bonds backed by student loans.

Mr. Ackinson explained that the majority of KHESLC's outstanding debt is in the form of auction rate securities. There have been persistent problems with the auction mechanism for this form of debt since mid-August, which has increased KHESLC's borrowing costs.

Mr. Ackinson said that by converting its debt to variable rate demand obligations (VRDOs), KHESLC can eliminate some of the risk that there will be a mismatch between the rates the corporation pays on its debt and the payments it receives from the federal government. He said VRDOs have not been affected by the credit crunch in the same way auction rate securities have been impacted. KHESLC would effectively be able to return to the same borrowing levels that it has enjoyed in the past.

Mr. Ackinson said KHESLC would have to incur the various transaction costs associated with this transaction. Through this process, KHESLC would also like to take the opportunity to diversify the broker/dealers involved. Principally, UBS is KHESLC's broker/dealer on auction rate securities, and KHESLC proposes to bring in other broker/dealers as remarketing agents. He said this is appropriate as this is a large transaction, and it is highly unlikely that one firm will be able to provide a liquidity facility, in the form of a stand-by bond purchase agreement, for the entire transaction. Mr. Ackinson said KHESLC issued the Request for Proposals for Bond Purchase Agreements December 14 with responses due in ten days. He said there may not be enough interest, because of liquidity problems in the market, for the agency to refund this much outstanding debt.

To summarize, he said KHESLC currently has outstanding debt of \$2.2 billion. The proposed new bond issue would refund approximately half that amount and provide new money to continue student loan originations.

Senator Tori said this was a complicated process and given the market today, this was a smart move. Representative Wayne made a motion to approve the bond issue. The motion was seconded by Senator Buford and approved by unanimous roll call vote.

Ms. Fugate presented the next bond issue for the Kentucky Housing Corporation (KHC) Multifamily Housing Revenue Bonds, Series 2008 (Alco Properties Projects), \$4,455,000. The proceeds from this issue will provide conduit financing for the acquisition and rehabilitation of low-income multifamily housing in Georgetown, Stanford, and Munfordville.

Representative Wayne made a motion to approve the bond issue. The motion was seconded by Representative Rudy and approved by unanimous roll call vote.

The last bond issue Ms. Fugate reported was KHC Conduit Multifamily Mortgage Revenue Bonds, Series 2007 (Overlook Terraces Project), \$10,000,000. Ms. Fugate said the proceeds from this issue will finance the construction of 144 units of low-income multifamily housing located on Glimmer Way in Louisville.

Representative Wayne said according to guidelines, the local people need to be notified including legislators and mayors. He asked if this had been done. Rick McQuady, Interim Chief Financial Officer, KHC, responded affirmatively.

Senator Seum said he had talked with the developer. They did contact the neighborhood organization that would be affected, and no one objected. He noted his concerns had been addressed.

Senator Buford made a motion to approve the bond issue. The motion was seconded by Representative Rudy and approved by unanimous roll call vote.

Ms. Fugate then presented a follow-up report for a previously approved bond issue for Kentucky Economic Development Finance Authority (KEDFA) Adjustable Rate Industrial Building Revenue Bonds, Series 2007 (Goodwill Industries of Kentucky, Inc.) for \$10,000,000. This bond issue was approved at a previous Committee meeting, and no action was required.

Ms. Fugate presented one new school bond issue with School Facilities Construction Commission debt service participation for Oldham County.

Representative Wayne made a motion to approve the school bond issue. The motion was seconded by Senator Rhoads and approved by unanimous roll call vote.

Next Ms. Osborne reported that there were three locally funded school bond issues submitted to the Committee for review this month for Grayson County, Scott County, and Woodford County. She said all disclosure information has been filed, and no further action on the bond issues was required.

Ms. Osborne noted the Committee's next meeting is tentatively scheduled for February 19, 2008, in the Capitol Annex building. With there being no further business, a motion was made and seconded to adjourn the meeting. The meeting adjourned at 1:30 p.m.